Benefits and Employment Briefing

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DOL RELEASES MODEL CHIP NOTICE

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Continued on page 2

IRS MANDATES SELF-REPORTING OF WELFARE PLAN EXCISE TAXES

Years - and in some cases *decades* - after the enactment of excise taxes on violations of Tax Code provisions relating to employer health plans, the IRS has finally issued guidance on

Continued on page 3

LATE COBRA NOTICE VOIDS STOP-LOSS COVERAGE

A recent decision by an Illinois federal court (*Majestic Star Casino, LLC v. Trustmark Insurance Co.*) carries two important lessons for sponsors and administrators of self-funded

Continued on page 5

EFAST2 ELECTRONIC FILING SYSTEM

Effective for plan years beginning on or after January 1, 2009, all sponsors of pension and welfare plans and Direct Filing Entities that are required to file a Form 5500 under Title I of ERISA

Continued on page 7

IRS OPENS DETERMINATION LETTER PROGRAM TO REMAINING PLANS

Rounding out the final year of its first five-year cycle, the IRS has now opened its determination letter program for individually designed retirement plans to those plans falling within "Cycle E." .

Continued on page 7

DOL ADOPTS SAFE-HARBOR RULE FOR DEPOSITING PARTICIPANT CONTRIBUTIONS

For years, the Department of Labor ("DOL") has focused much of its enforcement resources on delinquent deposits of participant contributions.

Continued on page 8

HEART ACT GUIDANCE INCLUDES SOME SURPRISES

In June of 2008, the Heroes Earnings Assistance and Relief Tax ("HEART") Act became law. The Act made a number of

Continued on page 9

IRS ISSUES GUIDANCE ON CORRECTING DEFECTS IN NONQUALIFIED PLAN DOCUMENTS

The American Jobs Creation Act of 2004 changed the landscape of compensation arrangements by adding Section 409A of the Internal Revenue Code, which imposes strict

Continued on page 13

DOL RELEASES MODEL CHIP NOTICE

As we reported in our February 2009 article, the Children's Health Insurance Program Reauthorization Act of 2009 ("CHIPRA") directed the Department of Labor ("DOL") to draft model notices by which sponsors of employer group health plans could notify their employees of the premium assistance made available under both CHIP and Medicaid. The DOL has now issued a model notice that may be used for this purpose.

For the first time, CHIPRA gave states the option of using CHIP and/or Medicaid funds to subsidize premiums for coverage under employer health plans. Although not all states have chosen to take advantage of this option, 40 states have now done so (all but Connecticut, Delaware, Illinois, Indiana, Maryland, Michigan, Mississippi, Ohio, South Dakota, Tennessee, and the District of Columbia). Employers offering health coverage to employees living in any of the 40 states that offer this premium assistance must provide those employees with either this model notice or one tailored to the state or states in which those employees live.

The model notice is relatively short, containing only a brief overview of the premium assistance program and contact information for all 40 states in which the assistance is available. Although the DOL's intent in drafting this single notice was to allow employers to avoid issuing separate notices to employees living in different states, the DOL has made clear that employers with employees in only a few states should feel free to supplement the notice with information specific to those states. Employers may use the contact information contained in the model notice to learn if states have additional language they suggest be included.

This notice must be provided automatically and at no cost. Moreover, this is yet another *annual* notification obligation. The first notice is due by the first day of the first plan year beginning after February 4, 2010 (when the notice was issued). Thus, calendar-year plans must provide the notice by January 1, 2011. Plans with plan years beginning before May 1, 2010, need not provide the notice before that date.

This notice may be provided concurrently with other materials, such as enrollment packets, open season materials, or the plan's summary plan description. Many employers will no doubt choose the open enrollment option. Those employers should keep in mind, however, that this notice must go to *all* eligible employees residing in any of the 40 states that offer premium assistance, regardless of whether those employees are actually enrolled in the employer's health plan. Moreover, if this notice is combined

with other materials, the notice must appear separately and in a manner which ensures that employees who may be eligible for the premium assistance could reasonably be expected to appreciate its significance.

Although sponsors of calendar-year plans need not take immediate action to comply with this notification requirement, they will want to ensure that this model notice (or some variation thereof) is provided to all of the required employees in advance of the January 1, 2011, deadline.

Kenneth A. Mason, Partner
Spencer Fane Britt & Browne LLP

IRS MANDATES SELF-REPORTING OF WELFARE PLAN EXCISE TAXES

Years - and in some cases *decades* - after the enactment of excise taxes on violations of Tax Code provisions relating to employer health plans, the IRS has finally issued guidance on how those taxes are to be reported and paid. Significantly, the burden is now on employers and plan administrators to *self-report* these taxes. Failure to do so on a timely basis could lead to substantial filing penalties.

This IRS guidance was issued in September of 2009, as part of a regulation defining "comparable" employer contributions to employees' health savings accounts ("HSAs"). Because this comparability requirement may be avoided simply by allowing employees to make their own HSA contributions through a cafeteria plan - as most employers do - the excise tax component of this regulation package was actually more significant.

These excise taxes are to be reported and paid by filing an IRS Form 8928. Although the IRS has released a *draft* of this Form, it has yet to issue either a final version or accompanying instructions.

The violations for which excise taxes are reportable on Form 8928 run the gamut of health plan requirements, including taxes imposed under the following statutory provisions:

- The COBRA coverage continuation requirements;
- The HIPAA portability requirements (including issuance of creditable coverage certificates, limitations on pre-existing condition exclusions, offering special enrollment periods, and refraining from discrimination on the basis of health status);
- Minimum coverage of hospital stays for

childbirth, as required under the Newborns' and Mothers' Health Protection Act;

- The provision of breast reconstruction benefits following mastectomies, as required under the Women's Health and Cancer Rights Act;
- The Mental Health Parity and Addiction Equity Act;
- The Genetic Information Nondiscrimination Act;
- The extension of coverage for dependent children losing student status due to illness or injury, as required under "Michelle's Law";
- The failure to make comparable employer contributions to HSAs; and
- The failure to make comparable employer contributions to Archer Medical Savings Accounts.

The deadline for filing a Form 8928 to report any of these violations (aside from the comparable employer contribution requirement) is the deadline for filing the sponsoring employer's federal income tax return - *excluding* any extensions. For a calendar-year corporation, this deadline would be March 15 following the calendar year of the violation.

Multiemployer health plans have seven months following the close of the plan year to report and pay these excise taxes. Violations of the comparability requirement must be reported by April 15 of the calendar year following the calendar year in which the noncomparable contributions were made.

These new reporting requirements apply to excise tax returns due on or after January 1, 2010. This means they are already in effect for violations occurring during 2009.

This guidance does *not* mean that plan sponsors should rush to file these returns. Preexisting IRS guidance provides relief from many of the excise taxes under various circumstances, including unintentional violations. Where there is no tax due, there is no obligation to file this return.

Moreover, most of the violations will not result in any excise taxes if a failure to comply is "corrected" before the IRS discovers the violation. According to the IRS, such correction requires that the failure be retroactively undone to the extent possible and that affected individuals be placed in a financial position as good as they would have been in had the violation not occurred.

These new excise tax reporting regulations heighten the importance of monitoring compliance with these various health plan

requirements and then correcting any violations *before* they come to the attention of the IRS.

Kenneth A. Mason, Partner
Spencer Fane Britt & Browne LLP

LATE COBRA NOTICE VOIDS STOP-LOSS COVERAGE

A recent decision by an Illinois federal court (*Majestic Star Casino, LLC v. Trustmark Insurance Co.*) carries two important lessons for sponsors and administrators of self-funded health plans. Unfortunately for the plan sponsor involved in this case, those lessons came at a steep price - in the form of denied stop-loss claims.

Majestic sponsored a self-funded health plan. It purchased a stop-loss policy from Trustmark, with a specific attachment point of $100,000. Although the stop-loss policy covered COBRA participants, it specifically conditioned that coverage on each COBRA qualified beneficiary receiving "a valid COBRA extension offer within the 30 days immediately following a COBRA qualifying event."

The Plan contained a provision under which coverage would continue - at the active employee premium - during the first 90 days of a medical leave of absence. According to the Plan, however, "[c]overage under this provision runs concurrently with coverage continued under COBRA."

Two Majestic employees incurred substantial medical claims while on 90-day medical leaves. Consistent with Majestic's standard policy of issuing COBRA election notices only after the 90th day of such a leave, neither employee received a COBRA notice within 30 days after the leave began. One employee returned to work within two months, and therefore *never* received a COBRA notice. The other employee was terminated at the end of the 90-day leave and was issued a COBRA notice shortly thereafter.

Trustmark denied stop-loss claims filed in connection with both of these employees. Although the parties disagreed as to the amount of stop-loss reimbursements at stake, it was somewhere between $208,000 and $345,000. According to Trustmark, Majestic's failure to provide a COBRA election notice within 30 days of each leave's commencement violated the policy provision on this point, and therefore relieved Trustmark of any obligation under the policy.

The Court agreed with Trustmark, pointing to language in the Plan document stating that coverage under the leave continuation provision "runs concurrently with coverage

under COBRA." The COBRA qualifying event was therefore the *commencement* of a leave. Because the stop-loss policy clearly conditioned coverage of COBRA beneficiaries on their receiving a COBRA election notice within 30 days of a COBRA qualifying event, Majestic's policy of deferring such notices until the *end* of a 90-day leave voided its right to coverage under the policy.

Majestic argued that the Plan's continuation of coverage at the active employee premium during the first 90 days of a leave meant that an employee did not "lose coverage" - and therefore did not experience a COBRA qualifying event - until the *end* of the leave. Moreover, Majestic employees testified that their consistent practice was to offer employees *both* the 90-day leave continuation *and* 18 months of COBRA coverage.

According to the court, however, Trustmark issued its stop-loss policy on the basis of the Plan language, rather than Majestic's (rather strained) interpretation of that language. Accordingly, Trustmark could not be forced to pay claims incurred by COBRA beneficiaries who did not receive a COBRA election notice within 30 days of a leave's commencement.

Sponsors and administrators of self-funded health plans should draw two important lessons from this decision. First, know what your plan provides concerning the interaction of COBRA coverage and other coverage continuation rights. Does that other continuation coverage run *concurrently* with COBRA coverage? Or does COBRA coverage commence only *after* the other continuation coverage has expired?

If the two types of coverage run concurrently, the total period of continuation coverage will be shorter. On the other hand, deferring the commencement of COBRA coverage to the end of the non-COBRA continuation period allows more time to provide a COBRA election notice. And in certain instances - as in the case of the employee who returned to work during the 90-day medical leave - this approach may even eliminate the need to provide a COBRA election notice.

Second, know what your stop-loss policy requires. If the policy contains notification deadlines that are inconsistent with your current practice, either negotiate changes to the policy or change your notification practices to comply with the policy conditions. Absent one of these two approaches, the plan (or the sponsoring employer) may be on the hook for substantial claims that would otherwise be reimbursable under the stop-loss policy.

Kenneth A. Mason, Partner
Spencer Fane Britt & Browne LLP

Benefits and Employment Briefing

EFAST2 ELECTRONIC FILING SYSTEM

Effective for plan years beginning on or after January 1, 2009, all sponsors of pension and welfare plans and Direct Filing Entities ("DFEs") that are required to file a Form 5500 under Title I of ERISA must do so electronically through the Employee Benefit Security Administration's ("EBSA") computerized ERISA Filing Acceptance System ("EFAST2"). In addition, delinquent and amended filings generally must be submitted electronically through EFAST2.

Form 5500 filers may use one of two methods for preparing and submitting filings under EFAST2. First, filers may use the free, web-based Form 5500 filing system developed by the EBSA and known as IFILE. Filers may access IFILE online at http://www.efast.dol.gov.

Alternatively, filers may use EFAST2-approved third party software. Such software may offer some benefits over IFILE. For example, IFILE does not include filing assistance or integrated instructions, and it cannot be used to transmit batches of filings. EFAST2-approved third party software may provide these types of support. A list of EFAST2-approved third party software vendors is available at http://www.efast.dol.gov.

Plan sponsors may continue to submit 2008 Forms 5500 - including delinquent or amended 2008 Forms - on paper through October 15, 2010, or electronically through EFAST (also known as EFAST1) through June 30, 2010. They may also file 2008 returns electronically through EFAST2.

Form 5500-EZ cannot, however, be submitted electronically. Instead, a single-participant plan that is eligible to file Form 5500-EZ (and is not required to file under Title I of ERISA) may elect to file Form 5500-SF electronically with EFAST2, instead of filing Form 5500-EZ on paper with the IRS. A single-participant plan that is not eligible to file Form 5500-SF must file Form 5500-EZ on paper with the IRS.

For more information about the EBSA's mandatory electronic filing requirement, see the EFAST2 website at http://www.efast.dol.gov.

Melissa R. Hinkle, Benefits Analyst
Spencer Fane Britt & Browne LLP

IRS OPENS DETERMINATION LETTER PROGRAM TO REMAINING PLANS

Rounding out the final year of its first five-year cycle, the IRS has now opened its determination letter program for individually designed retirement plans to those plans falling within "Cycle E." These are plans sponsored by employers whose employer

identification number ends with either "5" or "0."

The deadline for Cycle E plans to submit an application for an updated determination letter is January 31, 2011. Governmental plans that chose to wait until Cycle E (rather than filing in Cycle C, where they normally fall) must also file by this deadline. Any existing determination letter will become obsolete on this date, so the failure to file by this deadline would leave the plan with no determination letter whatsoever.

Before submitting a determination letter application, a number of other steps must first be completed. These include the following:

1. The plan must be reviewed for changes required by the IRS's "2009 Cumulative List of Changes," which was issued in December of 2009.

2. Any required changes must be incorporated into a complete restatement of the plan document, along with any changes made by amendments to the prior restatement and any additional plan-design changes.

3. Finally, the application must be prepared and participants must be given advance notice of its filing.

In order to accomplish all of these steps by the deadline of January 31, 2011, work should begin now. This is particularly true for those sponsors who wish to receive a favorable determination letter without an extended delay. The IRS has made clear that applications filed early within a filing cycle will be considered before any later-filed applications.

Although these rules apply only to individually designed plans, adopters of prototype and volume submitter plans face an even tighter deadline. All such defined contribution plans must be restated to reflect changes required by the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA") by April 30, 2010. If such an EGTRRA restatement has not yet been adopted, any employer relying on this type of plan should contact the sponsor of their prototype or volume submitter document to initiate this process without delay.

Kenneth A. Mason, Partner
Spencer Fane Britt & Browne LLP

DOL ADOPTS SAFE-HARBOR RULE FOR DEPOSITING PARTICIPANT CONTRIBUTIONS IN SMALL PLANS

For years, the Department of Labor ("DOL") has focused much of its enforcement resources on delinquent deposits of participant contributions. Under the general

rule set forth in existing regulations, participant contributions to ERISA plans become plan assets "as soon as they can reasonably be segregated" from the employer's general assets. The current regulations set outer limits on when participant contributions become plan assets (90 days for welfare plans; for retirement plans, 15 business days after the end of the month in which the employer either receives the amount or would have paid it in cash to the participant). However, we have always cautioned employers that the outer limits are *not* safe harbors. Employers cannot rely on them if it is shown that the employer could reasonably have segregated the contributions earlier.

In an effort to provide certainty to small employers in this area, the DOL has now finalized a safe-harbor rule for determining *when* participant contributions become plan assets. Under the final safe harbor, sponsors of "small" plans will be deemed to have complied with the general rule if the contributions are deposited within seven business days after they are received (if the contributions are paid to the employer) or otherwise would have been paid in cash (if the contributions are withheld from wages). A small plan is one with fewer than 100 participants at the *beginning* of the plan year.

The deposit timing rules apply not only to participant elective deferrals, but also to plan loan repayments. The final rule states that seven business days is merely a safe harbor; *i.e.*, it is not the exclusive means for determining whether the general deposit timing rule has been met. Thus, a small plan might still satisfy the general "as soon as they can reasonably be segregated" rule, even if contributions are deposited more than seven business days after they are received (or would have been paid).

The rule applies equally to retirement and welfare plans. However, the Preamble to the new regulations confirms that Technical Release 92-01 (which established a non-enforcement policy for certain unfunded welfare plans with respect to ERISA's trust requirement) remains in effect.

The new rule is effective immediately. Small employers should evaluate whether their existing practices comply with the safe harbor. If not, they should consider accelerating the process for remitting participant contributions in order to take advantage of the safe harbor.

Julia M. Vander Weele, Partner
Spencer Fane Britt & Browne LLP

HEART ACT GUIDANCE INCLUDES SOME SURPRISES

In June of 2008, the Heroes Earnings Assistance and Relief Tax ("HEART") Act became law. The Act made a number of significant changes to the treatment of

military reservists under employee benefit plans. In an August 2008 article, we summarized those changes as they applied to qualified defined benefit and defined contribution plans, Section 403(b) plans, and Section 457(b) plans. In January of 2010, the IRS issued Notice 2010-15 (the "Notice"), which contains guidance on a number of the Act's provisions. This article summarizes the most significant and surprising elements of that guidance, which apply to differential wage payments, "in-service" distributions on a reservist's deemed severance from employment, and the Act's mandatory death benefit provisions.

Differential Wage Payments

Some employers continue to pay part or all of a reservist's wages when the reservist is called to active duty. As we reported in our earlier article, the HEART Act changed the tax treatment of these "differential wage" payments. Prior to the Act, differential wage recipients were usually treated as independent contractors. Accordingly, differential wages were usually reported on Form 1099, rather than Form W-2. The HEART Act required that such payments not only be treated as W-2 wages, but that they be treated as "compensation" for retirement plan purposes.

Based on the language of the statute (and the conference committee report on the new statutory language), most employers and commentators concluded that differential wage payments must be included as compensation for *benefit accrual* purposes under retirement plans covered by the Act. In the Notice, however, the IRS has taken a contrary position.

According to the Notice, differential wage payments must be treated as compensation only for purposes of applying the annual Code Section 415 limits. They may - but need not - be treated as compensation for benefit accrual purposes.

In fact, the Notice states that differential wage payments need not be included in a plan's accrual definition of compensation, even if that definition is intended to satisfy a nondiscrimination safe harbor under Code Section 414(s). This is a surprising interpretation because such safe-harbor definitions must be based on a definition of compensation that could be used for Section 415 testing. The Notice does not explain (or cite any authority for) this interpretation.

Distributions upon Deemed Severance from Employment

As we discussed in our August 2008 article, the HEART Act includes a rule intended to facilitate "in-service" distributions from defined contribution plans. Such plans are required to treat participants who have been on active duty in the uniformed services for more than 30 days as having severed their employment for purposes of determining whether they are eligible for a distribution of

the following amounts: 401(k) elective deferrals; salary reduction amounts under Section 403(b) plans; all contributions to 403(b)(7) custodial accounts; and deferrals under eligible Section 457(b) plans. Recipients of such "in-service" distributions are not permitted to make elective deferrals or employee contributions to the plan for the six months following the distribution.

The statutory language raised three questions with respect to this rule. The first was based on the statutory heading under which the provision appeared, which reads: "Treatment of Differential Wage Payments." This caption led some commentators to conclude that the "in-service" distribution provisions apply only to differential wage recipients. The Notice clarifies that the rule applies to *any* participant who has been on active duty for a period of more than 30 days.

The second question was whether plans are *required* to permit "in-service" distributions once the participant has satisfied the 30-day active-duty requirement. The Notice answers this question in the negative: although plans are required to treat such participants as having experienced a severance from employment, they are not required to provide "in-service" distributions on account of such severance, *even if the participant would be entitled to such a distribution* upon a true severance from employment.

In other words, affected plans are free to impose two separate rules - one for "true" severances, and another for "deemed" severances. Plan sponsors may wish to amend their plans to clarify when distributions will be permitted based on the two different types of severance.

The final question concerned how to coordinate two closely related types of special distributions to reservists on active duty: qualified reservists distributions ("QRDs") and "in-service" distributions upon a deemed severance from employment. As discussed in our earlier article, QRDs were created by the Pension Protection Act of 2006 (the "PPA") to allow certain participants in Section 401(k) and Section 403(b) plans to receive special distributions while on active duty. QRDs are exempt from the 10% penalty that usually applies to distributions made before the participant has attained age 59½, and reservists may "repay" them to an IRA (during a specified two-year period), without regard to the usual IRA contribution limit.

The HEART Act eliminated the PPA's sunset provision, which restricted QRDs to reservists activated before December 31, 2007. The Act did not clarify, however, how QRDs would interact with the newly created "in-service" distributions discussed above. The Notice answers this question: if a plan provides for both QRDs and "in-service"

distributions, the distribution is deemed to be a QRD, to the extent possible. Thus, to the extent the distribution can be treated as a QRD, the participant is not subject to the six-month suspension that would apply in the case of an "in-service" distribution, need not pay the 10% penalty even if the amount is received before age 59½, and may repay the amount to an IRA under the QRD repayment rules.

Vesting Rule Clarified for Mandatory Death Benefit

As discussed in our earlier article, the HEART Act imposed a new requirement when a participant dies on or after January 1, 2007, while performing qualified military service. This rule requires qualified plans, Section 403(b) plans, and governmental Section 457(b) plans to pay any death benefit under the plan as if the participant had returned to work and then terminated employment on account of his or her death.

It was clear under the Act that this rule required such plans to fully vest any participant who died while in military service if he or she would have become fully vested upon death while an active employee. It was also clear that this rule required the plan to provide ancillary life insurance benefits to participants, who died in-service, if such benefits would be provided to participants who died while actively employed.

The Notice explains that this rule applies to *vesting* service, as well. That is, covered plans must provide participants who die while performing qualified military service with vesting credit for that period of military service. Under this rule, if a participant enters qualified military service while *nonvested*, then dies on or after the date he or she would have become vested had he or she remained an active employee, the plan must vest him or her - even if the plan does not automatically vest active employees on death.

Action Items

Sponsors should carefully review their plan documents to ensure compliance with the clarifications (and new rules) included in the Notice.

Plan amendments for the HEART Act's mandatory provisions are generally not required until the end of the 2010 plan year (2012 for governmental plans). Plan sponsors who have already amended their plans to ensure compliance will need to review those amendments in light of the Notice.

In particular, plan sponsors who amended their plans to include differential wage payments in the plan's benefit accrual definition of compensation will want to consider whether to change course now that the Notice has provided the option of excluding such payments. Such amendments must be carefully drafted, however. They might need to be *prospective* only, because anti-cutback rules may apply

to benefits already accrued.

Lawrence Jenab, Partner
Spencer Fane Britt & Browne LLP

IRS ISSUES GUIDANCE ON CORRECTING DEFECTS IN NONQUALIFIED PLAN DOCUMENTS

The American Jobs Creation Act of 2004 changed the landscape of compensation arrangements by adding Section 409A of the Internal Revenue Code, which imposes strict operational and documentation requirements on nonqualified deferred compensation arrangements. Section 409A applies to any plan, agreement, or arrangement that creates (in a given tax year) a legally binding right to compensation that is payable in a later year. Consequently, Section 409A applies to a wide variety of arrangements, including supplemental retirement programs, bonus plans, incentive compensation arrangements, employment agreements, severance agreements, and equity compensation plans.

Generally, a plan or arrangement subject to Section 409A must be in writing, and the plan document must specify the amount deferred (or a formula for determining that amount), the time and form of payment (including, if applicable, a six-month delay for payments to "key" employees of publicly traded companies), and the conditions under which initial and subsequent deferral elections may be made. In addition, the written plan must not permit any impermissible acceleration of payment by either the employer or the employee (a term that includes, for purposes of this article, independent contractors). Failure to comply with Section 409A (in either form or operation) results in (i) immediate taxation of the amounts deferred, (ii) a 20% penalty tax, and (iii) interest (at the federal underpayment rate plus 1%) from the date the employee was first vested in the deferred compensation.

Although Section 409A applies to all amounts deferred or vesting after December 31, 2004, the IRS regulations interpreting and implementing Section 409A did not become fully effective until January 1, 2009. Prior to that date, plans were subject to a "reasonable, good-faith" standard for operational compliance, but were not required to have a fully 409A-compliant plan document. In December of 2008, the IRS issued guidance (Notice 2008-113) describing a program for correcting certain operational defects in nonqualified plans subject to Section 409A. However, until recently, there was no formal program or guidance for correcting plan documents that were not 409A-compliant by the January 1, 2009, deadline.

On January 5, 2010, the IRS issued Notice 2010-6, which provides relief for certain plan

document failures under Section 409A if they are properly corrected. The Notice provides "fixes" for many (but not all) such failures. Notice 2010-6 is welcome guidance for both employers and employees because it allows the parties to avoid the harsh tax consequences of a technical 409A failure that may be attributable solely to the inadvertent inclusion of a provision that is contrary to (or the exclusion of a provision that is required by) Section 409A.

Transition Relief

Under a special transition rule, certain plan document failures that are corrected by December 31, 2010, will be treated as having been corrected on January 1, 2009 - the first day that plans were required to be in full documentary compliance with Section 409A. Under the transition rule, there is no income inclusion (and no 20% penalty) so long as any *operational* failures related to the documentary failure are corrected in accordance with IRS Notice 2008-113.

There is also transition relief for corrections made by December 31, 2011, where the document failure involves a payment schedule that is determined by the timing of payments received by the employer (such as payments based on accounts receivable). Moreover, although the documentary correction guidance generally does not apply to employers or employees that are under audit, there is a transition rule that will allow certain defects to be corrected if the audit relates solely to tax periods beginning on or before December 31, 2011.

General Requirements for Correction

In order to take advantage of the document correction guidance, several general requirements must be satisfied. First, the failures must be inadvertent and unintentional. Second, the employer must take "commercially reasonable" steps to identify and correct all other plans and arrangements subject to Section 409A with the same or substantially the same documentary failure. Third, neither the employer's nor the employee's federal income tax return may be under examination with respect to nonqualified deferred compensation for any taxable year in which the failure existed. Fourth, if required by the specific correction procedure, the employee must include the applicable percentage (generally either 25% or 50%) of the deferred amount as taxable income on his or her tax return, and must pay all applicable taxes, including the 20% penalty (but not the interest penalty), on the amount included in income. Finally, the employer must satisfy certain information and reporting requirements with respect to the failure.

Permissible Corrections

Six general categories of failures may be corrected under Notice 2010-6:

Impermissible Definition of Payment

Event. Under Section 409A, amounts deferred may generally be paid only upon (1) a specified date, (2) separation from service, (3) death, (4) disability, (5) change of control, or (6) unforeseeable emergency. Several of these terms have specific definitions under the final 409A regulations. Use of a different definition may result in a Section 409A violation.

Notice 2010-6 permits an employer to replace an impermissible definition with a compliant definition, provided the correction occurs before the date the payment event occurs. However, if the correction affects a distribution under the plan within one year, the affected employee must include in income the applicable percentage (50%, in the event of a defective definition of separation from service; 25% in the event of a defective definition of change of control) of the deferred amount, and must also pay the associated taxes.

Impermissible Payment Periods. The final 409A regulations permit payment during a period that is expressly limited to one tax year, or a period not longer than 90 days after the payment event. Notice 2010-6 permits the employer to amend a plan provision that contains a payment period longer than 90 days, or that conditions payment upon an employee's action during the payment period (such as execution of a release). If corrected before the date of the payment event, there are no tax consequences. If corrected within a reasonable period *after* the payment event, the employee must include in income 50% of the deferred amount and must pay the applicable 409A taxes.

Other Impermissible Payment Events or Impermissible Discretion. The final 409A regulations permit a plan to provide for different times or forms of payment for each permissible payment event, or to allow for different payment schedules depending on when the payment event occurs. Notice 2010-6 provides relief for plans with impermissible payment events or schedules, and for plans that impermissibly permit employer or employee discretion to change the time or form of payment. If correction is made before the date of the payment event, there are no tax consequences. If, however, the operation of the plan is affected by the correction within one year of the correction, the employee must include in income 50% of the deferred amount and must pay the associated 409A taxes.

Failure to Include the Six-Month Delay Rule. Plans of publicly traded employers must include a provision for a six-month delay in payments to certain "key" employees on account of a separation from service. Notice 2010-6 permits an employer to correct a plan that fails to include such a provision, so long as (i) the correction is made before the key employee's separation from service, and (ii) the plan is further amended to provide that payment may not be made before the later of 18 months after

the correction date or six months after the separation from service. If a key employee has a separation from service within one year of the correction, the employee must include in income (for the year of separation) 50% of the deferred amount and must pay the associated 409A taxes.

Impermissible Deferral Elections. A plan subject to Section 409A must generally provide that any compensation deferral election (by an employee) be made prior to the first day of the calendar year in which the compensation will be earned. Notice 2010-6 permits an employer to correct a plan document that includes an impermissible deferral election procedure. This correction may be made without tax consequences so long as the impermissible provision has not been "applied" by the employee or the employer.

If the provision has already been applied, the employer may correct the plan no later than the end of the second taxable year after the year in which the applicable deadline for making the deferral election occurred. In this case, however, the employer must also correct the "operational" error under IRS Notice 2008-113.

Initial Adoption of New Plan. Notice 2010-6 provides a transition period for document corrections (related to any of the types of errors listed above) that are made shortly after an employer's adoption of a new plan. The transition period generally ends at the end of the tax year in which the first legally binding right to deferred compensation arose. So long as the document errors are corrected within the transition period-and any associated operational errors are corrected under Notice 2008-113 - the correction may be made without tax consequences.

Guidance Regarding Documentary "Failures"

The Notice also provides guidance as to whether certain plan provisions result in Section 409A failures. Importantly, the Notice provides that certain ambiguous plan terms will not result in a plan document failure, so long as the plan is otherwise operated in compliance with Section 409A.

For example, the Notice provides that a plan provision providing for payment "as soon as practicable" following a permissible payment event does not, by itself, result in a document failure (as suggested by the final 409A regulations). Similarly, a plan that provides for payment upon "termination of employment" (rather than upon "separation from service," as defined in the 409A regulations) will not, by itself, result in a document failure - so long as that plan provision has been interpreted, for all periods after 2008, in a manner that is consistent with the 409A definition of separation from service. The Notice also confirms the effectiveness of plan provisions

requiring that all ambiguous or undefined terms be interpreted to comply with Section 409A.

Summary

Despite all efforts to identify nonqualified deferred compensation arrangements and amend them (by January 1, 2009) to comply with the strict requirements of the final 409A regulations, many employers still have plans or arrangements that do not comply with all of the documentary requirements of Section 409A. For unintentional document failures, the harsh tax consequences of a 409A failure may be avoided by correcting those document defects in accordance with Notice 2010-6.

Because the Notice includes transition relief for failures corrected before 2011 (and limited tax consequences for failures that are corrected before certain events occur), there is now additional incentive for employers to (i) identify all plans or arrangements that may be subject to Section 409A, (ii) review those plans for documentary compliance with Section 409A, and (iii) correct any plan document defects in accordance with the correction procedures set forth in Notice 2010-6.

Robert A Browning, Partner
Spencer Fane Britt & Browne LLP